J.K. SHAH
TEST SERIES
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SUGGESTED SOLUTION

FINAL MAY 2019 EXAM

SUBJECT- AUDIT

Test Code - FNJ 7133

BRANCH - () (Date :)

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Answer 1:

(A)

Projected Financial Statements : As per **SAE 3400, "The Examination of Prospective Financial Information"**, the answer is divided into two parts i.e. (i) the things to be considered before accepting the engagement and (ii) audit evidence to be obtained for reporting on projected financial statements.

(i) **Acceptance of Engagement :** As per SAE 3400, "The Examination of Prospective Financial Information", **before accepting an engagement** to examine prospective financial information, the auditor would consider, amongst other things :

(1) the intended use of the information;

(2) whether the information will be for general or limited distribution;

(3) the nature of the assumptions, that is, whether they are best – estimates or hypothetical assumptions;

(4) the elements to be included in the information; and

(5) the period covered by the information.

Further, the auditor should not accept, or should withdraw from, an engagement when the **assumptions are clearly unrealistic** or when the **auditor believes that the prospective financial information will be inappropriate for its intended use.**

In accordance with SA 210, "Terms of Audit Engagement", it is necessary that the auditor and the client should agree on the terms of the engagement. **(2.5 marks)**

(ii) **Audit evidence to be obtained for Reporting on Projected Financial Statements:** The auditor should document matters, which are important in **providing evidence to support his report on examination of prospective financial information**, and evidence that such examination was carried out.

The audit evidence in form of working papers will include:

(1) the sources of information,
(2) basis of forecasts,
(3) the assumption made in arriving the forecasts,
(4) hypothetical assumptions, evidence supporting the assumptions,
(5) management representations regarding the intended use and distribution of the information, completeness of material assumptions,
(6) management's acceptance of its responsibility for the information,
(7) audit plan,
(8) the nature, timing and extent of examination procedures performed, and,
(9) In case the auditor expresses a modified opinion or withdraws from the engagement, the reasons forming the basis of such decision. **(2.5 marks)**

(B)

Review by Engagement Partner: As per **SA 220, "Quality Control for an Audit of Financial Statements"**, the engagement partner shall take **responsibility for reviews being performed in accordance with the firm's review policies and procedures.** For audits of financial statements of listed entities, the engagement partner shall:

- Determine that an engagement quality control reviewer has been appointed;
- Discuss significant matters arising during the audit engagement, including those

identified during the engagement quality control review, with the engagement quality control reviewer; and

- Not date the auditor's report until the completion of the engagement quality control review. **(1.5 marks)**

SA 700, "Forming an Opinion and Reporting on Financial Statements", requires the auditor's report to be **dated no earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements.** In cases of an audit of financial statements of listed entities where the engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.

(1.5 marks)

In the instant case, OP & Associates are the statutory auditors of a listed company BB Ltd. Which started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor's report was dated May 12, 2018. During the documentation review of the engagement, i t was observed that the engagement quality control review was completed on May 15, 2018.

Thus, in the given case, signing of auditor's report i.e. on May 12, 2018 which is before the completion of review engagement quality control review i.e. May 15, 2018, is not in order.

(2 marks)

Answer 2:
(A)

Important Points to be kept in Mind While Drafting Letter of Weakness: As per **SA 265, "Communicating Deficiencies in Internal Control to Those who charged with Governance and Management",** the auditor shall include in the written communication of significant deficiencies in internal control -

(i) A description of the deficiencies and an explanation of their potential effects; and

(ii) Sufficient information to enable those charged with governance and management to understand the context of the communication. **(1 mark)**

In other words, the **auditor should communicate material weaknesses to the management** or the audit committee, if any, **on a timely basis**. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

(1) The letter lists down the area of weaknesses in the system and offers suggestions for improvement.

(2) It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.

(3) This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.

The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control. **(3 marks)**

(B)

Elements of the Practitioner's Report for Review Engagement: As per **<u>SRE 2400 "Engagements to Review Historical Financial Statements"</u>**, the practitioner's report for the review engagement shall be in writing, and shall contain the following elements:

(a) A title, which shall clearly indicate that it is the report of an independent practitioner for a review engagement;

(b) The addressee(s), as required by the circumstances of the engagement;

(c) An introductory paragraph that:

   (i) Identifies the financial statements reviewed, including identification of the title of each of the statements contained in the set of financial statements and the date and period covered by each financial statement;

   (ii) Refers to the summary of significant accounting policies and other explanatory information; and

   (iii) States that the financial statements have been reviewed;

(d) A description of the responsibility of management for the preparation of the financial statements, including an explanation that management is responsible for:

   (i) Their preparation in accordance with the applicable financial reporting framework including, where relevant, their fair presentation;

   (ii) Such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error;

(e) If the financial statements are special purpose financial statements:

   (i) A description of the purpose for which the financial statements are prepared and, if necessary, the intended users, or reference to a note in the special purpose financial statements that contains that information; and

   (ii) If management has a choice of financial reporting frameworks in the preparation of such financial statements, a reference within the explanation of management's responsibility for the financial statements to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances;

(f) A description of the practitioner's responsibility to express a conclusion on the financial Statements including reference to this SRE and, where relevant, applicable law or regulation;

(g) A description of a review of financial statements and its limitations, and the following statements:

   (i) A review engagement under this SRE is a limited assurance engagement;

   (ii) The practitioner performs procedures, primarily consisting of making inquiries of management and others within the entity, as appropriate, and applying analytical procedures, and evaluates the evidence obtained; and

   (iii) The procedures performed in a review are substantially less than those performed in an audit conducted in accordance with Standards on Auditing (SAs), and, accordingly, the practitioner does not express an audit opinion on the financial statements;

(h) A paragraph under the heading "Conclusion" that contains:

   (i) The practitioner's conclusion on the financial statements as a whole in accordance with this SRS, as appropriate; and

   (ii) A reference to the applicable financial reporting framework used to prepare the financial statements.

(i) When the practitioner's conclusion on the financial statements is modified:

   (i) A paragraph under the appropriate heading that contains the practitioner's modified conclusion in accordance with this SRS, as appropriate; and

(ii) A paragraph, under an appropriate heading, that provides a description of the matter(s) giving rise to the modification;

(j) A reference to the practitioner's obligation under this SRE to comply with relevant ethical Requirements;

(k) The date of the practitioner's report;

(l) The practitioner's signature; and

(j) The place of signature. **(6 marks)**

Answer 3:

(A)

<u>As per SA 810, "Engagement to Report on Summary Financial Statements"</u>, the auditor shall perform the following procedures, and any other procedures that the auditor may consider necessary, as the basis for the auditor's opinion on the summary financial statements:

(i) Evaluate whether the summary financial statements adequately disclose their summarized nature and identify the audited financial statements.

(ii) When summary financial statements are not accompanied by the audited financial statements, evaluate whether they describe clearly:

(1) From whom or where the audited financial statements are available; or

(2) The law or regulation that specifies that the audited financial statements need not be made available to the intended users of the summary financial statements and establishes the criteria for the preparation of the summary financial statements.

(i) Evaluate whether the summary financial statements adequately disclose the applied criteria.

(ii) Compare the summary financial statements with the related information in the audited financial statements to determine whether the summary financial statements agree with or can be re – calculated from the related information in the audited financial statements.

(iii) Evaluate whether the summary financial statements are prepared in accordance with the applied criteria.

(iv) Evaluate, in view of the purpose of the summary financial statements, whether the summary financial statements contain the information necessary, and are at an appropriate level of aggregation, so as not be misleading in the circumstances.

Evaluate whether the audited financial statements are available to the intended users of the summary financial statements without undue difficulty, unless law or regulation provides that they need not be made available and establishes the criteria for the preparation of the summary financial statements. **(5 marks)**

(B)

Using the Work of Another Auditor: When the accounts of the branch are audited by a person other than the company's auditor, there is need for a **<u>clear understanding of the role of such auditor</u>** and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is **<u>great necessity for a proper rapport between these two auditors for the purpose of an effective audit</u>**. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in **SA 600, "Using the Work of another Auditor".** It makes clear that in certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the **<u>principal auditor would normally be entitled to rely</u>** upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and / or to examine the books of account and other records of the said component.

Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

(1) advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co – ordination of their efforts at the planning stage of the audit. The principle auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter – component transactions that may require disclosure and the time – table for completion of audit ; and

(2) advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check – list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

Further, **SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services engagements"**, issued by the institute, provides that, unless otherwise specified by law or regulation, **audit documentation is the property of the auditor**. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided **such disclosure does not undermine the validity of the work performed**, or, in the case of assurance engagements, the independence of the auditor or of his personnel."

In the light of aforesaid, principal auditor was not within his right for asking for such sharing of working papers. It depends upon the discretion of auditor.

Answer 4:

(A)

Considerations for Planning and Performing Audit in case of Special Purpose Framework: As per **SA 800 "Special Considerations-Audits of Financial Statements Prepared in accordance with Special Purpose Frameworks"**, financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed. **(1 mark)**

While planning and performing audit of such special purpose framework based company, the auditor should consider below mentioned factors:

(i) To obtain an understanding of the entity's selection and application of accounting policies. In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements.

(ii) Compliance of all SAs relevant to audit, the auditor may judge it necessary to depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement.

(iii) Application of some of the requirements of the SAs in an audit of special purpose financial statements may require special consideration by the auditor. For example, in SA 320, judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. In the case of an audit of special purpose financial statements, however, those judgments are based on a consideration of the financial information needs of the intended users.

(iv) In the case of special purpose financial statements, such as those prepared in accordance with the requirements of a contract, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with SA 320 for purposes of planning and performing the audit of the special purpose financial statements.

Communication with those charged with governance in accordance with SAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility. **(4 marks)**

(B)

Difference of Opinion Among Joint Auditors: **SA 299 on, "Responsibility of Joint Auditors"** deals with the **professional responsibilities**, which the auditors undertake in accepting such appointments as joint auditors. In respect of the work divided amongst the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has made a separate report on the work performed by him. On the other hand the joint auditors are jointly and severally responsible in respect of the audit conducted by them as under: **(1 mark)**

In respect of the audit work which is not divided among the joint auditors and is carried out by all of them;

(i) in respect of decisions taken by all the joint auditors concerning the nature, timing or extent of the audit procedures to be performed by any of the joint auditors;

(ii) in respect of matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;

(iii) for examining that the financial statements of the entity comply with the disclosure requirements of the relevant statute;

(iv) for ensuring that the audit report complies with the requirements of the relevant statute;

(v) it is the separate and specific responsibility of each joint auditor to study and evaluate the prevailing system of internal control relating to the work allocated to him, the extent of enquiries to be made in the course of his audit;

(vi) the responsibility of obtaining and evaluating information and explanation from the management is generally a joint responsibility of all the auditors;

(vii) each joint auditor is entitled to assure that the other joint auditors have carried out their part of work in accordance with the generally accepted audit procedures and therefore it would not be necessary for joint auditor to review the work performed by other joint auditors. **(3 marks)**

Normally, the joint auditors are able to arrive at an agreed report. However **where the joint auditors are in disagreement with regard to any matters** to be covered by the report, each one of them should express their own opinion through a separate report. A joint auditor is not bound by the views of majority of joint auditors regarding matters to be covered in the report and should express his opinion in a separate report in case of a disagreement.

In the instant case, there are three auditors, namely, Mr. X, Mr. Y and Mr. Z, jointly appointed as an auditor of KRP Ltd. For the valuation of gratuity scheme of the Company they referred their own known Actuaries. Mr. Z (one of the joint auditor) is not satisfied with the report submitted by Mr. Y's referred actuary. He is not agreed with the matters to be covered by the report whereas Mr. X agreed with the same. **(1 mark)**

Answer 5:

(1) B (2) D (3) A (4) B (5) A (6) C (7) D (8) A (9) C (10) A